Office of Chief Counsel
Internal Revenue Service
memorandum

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from: Janine Cook
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subject: RRTA Tax and Contract Cancellation Payments

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

IRS PRE-APPEALS CONFERENCE

1. Contract Right Payments Claim

I.R.C. SECTION 3231(E)(1)

The term "compensation" means any form of money remuneration paid to an individual for services rendered as an employee to one or more employers.

ISSUE

- Are "contract right payments" includible in compensation subject to RRTA tax?

FACTS

- We note that refund claims (-) were devoid of specific facts regarding the types of payments included in this portion of the claim but merely lists the following types of payments:

POSITION

- The protest includes the following very general statement: “Other portions of refund claim relates to various payments made to unionized employees to terminate their contract rights. Because RRT taxes, by their terms, apply only to ‘any form of money remuneration paid to an individual *for services rendered as an employee*,’ these taxes should not be applicable to payments made simply for relinquishment of contract rights, including specifically [the types of payments listed on prior slide].”

POSITION

- The entire basis for position is North Dakota State University v. United States, 255 F.3d 599 (8th Cir. 2001).
- NDSU held that payments to professors in exchange for their termination of employment and relinquishment of tenure rights were not wages, citing Rev. Rul. 58-301 and relying on the very unique facts of tenure.

GOVERNMENT’S POSITION

- “Compensation” is defined as any form of money remuneration paid to an individual for services rendered as an employee to one or more employers.
- Due to parallel treatment between FICA and RRTA, broad scope of wages also applies to “compensation.”
- Reference to “services rendered” does not require allocation of payments to specific services. See Social Security Board v. Nierotko, 327 U.S. 358 (1946); CSX, 518 F.3d 1328 (Fed. Cir. 2008); Abrahamsen v. United States, 228 F.3d 1360 (Fed. Cir. 2000). Cf. Kore v. Celebrezze, 342 F.2d 638 (7th Cir 1965)(social security benefits case).
- Overwhelming legal authority that severance payments in exchange for relinquishment of contract rights are money remuneration for services rendered.

GOVERNMENT’S POSITION

- Rev. Rul. 75-44 held that a lump-sum payment to a railroad employee in exchange for relinquishing seniority rights gained from his prior service under a general contract of employment was compensation for RRTA tax purposes.
- Rev. Rul. 2004-110 states, “Employment encompasses the establishment, maintenance, furtherance, alteration, or cancellation of the employer-employee relationship or any of the terms and conditions thereof. If the employee provides clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions, the payment is not wages for purposes of FICA, FUTA, or Federal income tax withholding.”

GOVERNMENT'S POSITION

- Chicago Milwaukee Corp. v. United States, 35 Fed. Cl. 447 (1996), aff'd, 141 F.3d 1112 (Fed. Cir. 1998), cert denied, 525 U.S. 932 (1998)—court held that payments made to former railroad employees to reimburse them for previous wage concessions under wage reduction agreements were compensation under RRTA.

GOVERNMENT'S POSITION

- NDSU nonwage conclusion does not apply and such holding should not be followed.
  - NDSU did not apply Rev. Rul. 75-44 to the tenured professors payments because of unique aspects of tenure.
  - NDSU held payments to administrators were wages.
  - NDSU relied significantly on Rev. Rul. 58-301, which was revoked by Rev. Rul. 2004-110.
  - Even for years prior to 2005 and for situations involving similar facts regarding tenure, NDSU is not binding in the 7th Circuit.

GOVERNMENT'S POSITION

- NDSU nonwage conclusion does not apply and such holding should not be followed (cont.).
  - The nonwage holding of NDSU was rejected by the Court of Federal Claims and the Federal Circuit Court of Appeals in CSX: "As we have noted, severance payments made to induce employees to relinquish employment-related rights are considered wages." 518 F.3d at 1349.
  - The nonwage holding of NDSU was rejected by the Sixth Circuit in Appoloni and the Third Circuit in University of Pittsburgh, in dealing with the same type of payments.
- The Quality Stores district court decision does not support argument that NDSU nonwage holding applies or should be followed. In fact, the bankruptcy opinion suggested the CSX court was right in rejecting NDSU nonwage conclusion.

GOVERNMENT'S POSITION

- We also note that the analysis herein applies as well to refute the brief statement in the claim and protest regarding a refund of RRTA taxes on signing bonuses. No facts are provided and no argument is offered other than a reference to other pending litigation and revoked rulings on unrelated facts.
- See Rev. Rul. 2004-109 for specific analysis.

CONCLUSION

- Payments upon termination of employment, even if in exchange for relinquishment of contractual employment rights, are wages and compensation.
- Rev. Rul. 75-44 is on point; Rev. Rul. 2004-110 also supportive.
- NDSU does not suggest and certainly does not require a different answer.

2. Severance Allowances Claim

I.R.C. SECTION 3231(E)(1)

The term "compensation" means any form of money remuneration paid to an individual for services rendered as an employee to one or more employers.

ISSUE

- Are severance allowances includible in compensation subject to RRTA tax?

CSX CORP. V. UNITED STATES

- Exact issue considered in CSX Corp. v. United States; case involved both payments to employees under FICA and employees under RRTA.
- Court of Federal Claims issued opinion in 2002 applying I.R.C. § 3402(o) to conclude that certain severance payments to former employees were not wages subject to FICA tax or compensation subject to RRTA tax. CSX Corp., 52 Fed. Cl. 208 (2002)
- The Court of Federal Claims determined that all payments subject to income tax withholding under I.R.C. § 3402(o) were not wages otherwise and applied this non-wage/compensation characterization for FICA/RRTA tax purposes as well.
- The Court of Appeals for the Federal Circuit reversed the holding, concluding that the severance payments were wages and compensation and that I.R.C. § 3402(o) did not provide to the contrary by it's "as if they were wages" language. CSX Corp., 518 F.3d 1328 (Fed. Cir. 2008).
- The Federal Circuit affirmed the broad scope of wages and compensation and that it does not have to be tied to particular services. 518 F.3d at 1333.
- The Federal Circuit reviewed the substantial case law involving dismissal payments (i.e., payments made upon involuntary termination) and concluded that many of them would satisfy parameters of I.R.C. § 3402(o) even though they were clearly wages for FICA tax purposes.
- "Th[e] potential conflict [with this case law] argues against reading section 3402(o) to suggest that all payments falling within the statutory definition of SUB must be deemed non-wages for FICA purposes." 518 F.3d at 1341.
- The Federal Circuit reviewed the historical legislative treatment of dismissal pay.
- Prior to 1950, the statutory definition of "wages" in FICA expressly excluded "[d]ismissal payments which the employer is not required to make." 26 U.S.C. § 1426(a)(4) (1946). Congress changed that rule in the Social Security Amendments Act of 1950, Pub. L. No. 81-734, 64 Stat. 477, which amended FICA by eliminating the exclusion of the so-called "dismissal payments" from FICA wages… Accordingly, as of 1950, it was clear that all payments made by an employer on account of the involuntary separation of an employee from service constituted wages within the meaning of FICA. See Abrahamsen, 228 F.3d at 1364." 518 F.3d at 1334.
- The Federal Circuit reviewed the IRS revenue rulings over the years since 1956.
- The court accepted the government's view that the Service's definition of SUB-Pay for its administrative exclusion in Rev. Rul. 90-72 (and predecessor rulings) is

different from the definition of SUB-pay in § 3402(o), and harmonized the Service's revenue rulings with the consistent FICA taxation of dismissal pay and the eventual enactment of I.R.C. § 3402(o) for income tax withholding.

QUALITY STORES, INC. V. UNITED STATES

- In February 2008, the bankruptcy court followed the Court of Federal Claims 2002 opinion in holding that the debtor's severance payments were not wages for FICA tax purposes.
- After the Federal Circuit opinion in CSX in summer 2008, the government sought reconsideration. The bankruptcy court ratified it's prior opinion.
- On February 23, 2010, the United States District Court for the Western District of Michigan affirmed the decision of the bankruptcy court, concluding that the severance payments were not wages for FICA tax purposes.
- Government is considering whether to appeal district court decision in Quality Stores.
- The district court followed the Court of Federal Claims opinion and rejected the Federal Circuit Court's opinion in CSX.
- The district court did not view the administrative exclusion in Rev. Rul. 90-72 as limiting the nonwage treatment that it thought applied to payments that otherwise fit within the parameters of I.R.C. § 3402(o).
- Important to consideration of the opinion is an understanding that the district court did not review the long line of dismissal pay cases.
- The district court cited to but did not analyze very relevant Sixth Circuit precedent. Appoloni v. United States, 450 F.3d 185 (6th Cir. 2006), held that severance payments to tenured employees who have given up their tenure rights constitute "wages" for FICA purposes, affirmed the breadth of the term "wages" and deferred to IRS Revenue Rulings.
- The district court also did not discuss Gerbec v. United States, 164 F.3d 1015 (6th Cir. 1999), and Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States, 64 F.3d 245 (6th Cir. 1995), both of which take a broad view of what payments constitute wages.
- The district court opinion in Quality Stores has no precedential effect, may be appealed and does not present as complete and considered an analysis as the Federal Circuit Court opinion in CSX.

CONCLUSION

- does not assert it satisfies the administrative exception in Rev. Rul. 90-72 for supplemental unemployment compensation linked to state unemployment benefits.
- Federal Circuit Court of Appeals decision in CSX case is persuasive and should be followed.

3. Stock/Equity Compensation Claims

I.R.C. Section 3231(e)(1)

The term "compensation" means any form of money remuneration . . . .

Issue

- Does "any form of money remuneration" exclude stock/equity payments from the RRTA?

Overview

- The RRTA and FICA are parallel statutes.
- "Money remuneration" does not have a single plain and unambiguous meaning.
- The best reading of "money remuneration" includes stock/equity payments.
- Rebuttal to Taxpayer's Arguments.

RRTA and FICA Are Parallels

- Same Time, Purpose, and Operation
- Differences = Result of Historical Realities
- Congress Identically Amends the Statutes

Deficit Reduction Act Conference Committee Report

The Railroad Retirement Tax Act (RRTA) applies to any form of money remuneration (Sec. 3231(e)). Regulations applicable to these statutes [FICA, FUTA, RRTA, and income tax withholding] specify that the value of any noncash item is to be determined by the excess of its fair market value over any amount paid by the recipient for the item . . . .

T.D. 8582

Legislation enacted since the adoption of the existing regulations has made the RRTA Tier 1 tax identical to the FICA tax as well as conforming the Tier 1 wage ceiling to the FICA wage ceiling.

Treasury Regulation 31.3231(e)-1

The term compensation has the same meaning as the term wages in section 3121(a), determined without regard to section 3121(b)(9), except as specifically limited by the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code) or regulation.

"Money" does not have a plain and unambiguous meaning

- RRTA does not define it.
- Code does not define it.
- Some dictionary defs exclude stock/equity.
- Some dictionary defs include stock/equity.
- Depression-era cases interpret money to include stock.
- Code uses it in different ways.

Summary

"Any form of money remuneration" does not have a plain and unambiguous meaning.

The best reading of "money" includes stock/equity payments.

- Principles of statutory interpretation dictate this conclusion.
- Do not interpret a term so as to render other terms inoperative
- If "money remuneration" only meant "cash remuneration," it would not be necessary for Congress to exclude from RRTA:
  - Fringe Benefits (3231(e)(5)
  - Employee-Achievement Awards (3231(e)(5))
  - Meals and Lodging (3231(e)(9))
  - Certain stock options (3231(e)(12))
- Presumption: Different words have different meanings
  - Section 3231(e)(1) defines "compensation" as "any form of money remuneration."
  - Section 3231(e)(3) states that "compensation" includes "cash tips."
- Congress does not intend for "money" to have the same meaning as "cash."

Rebutting Specific Arguments: Part 1

Taxpayer argues that to interpret "money remuneration" as encompassing only "cash" does not render RRTA's exclusions superfluous, because these exclusions can be provided in cash.

Qualified Employee Discounts

- Code never states that this can be cash.
- Reg. 1.132-3(a)(4) allows for cash rebates, but did not exist when Congress excluded fringe benefits from the RRTA.
  - Not adopted until 1989 (T.D. 8256, July 6, 1989)
  - Superfluous when excluded from RRTA, if "money remuneration" means cash.

- Substantively, not cash, but a discount.

Working Condition Fringes

- Code never states that this can be cash.
- Reg. 1.132-5(a)(1)(v) allows reimbursement, but did not exist when Congress excluded fringe benefits from the RRTA.
  - Not adopted until 1989 (T.D. 8256, July 6, 1989)
  - Superfluous when excluded from RRTA, if "money remuneration" means cash.
- Substantively, not cash, but an in-kind benefit.

De Minimis Fringes

- Code never states that this can be cash.
- Reg. 1.132-6(d) allows for cash, but did not exist when Congress excluded fringe benefits from the RRTA.
  - Not adopted until 1989 (T.D. 8256, July 6, 1989)
  - Superfluous when excluded from RRTA, if "money remuneration" means cash.
- Substantively, not cash, but an in-kind benefit (e.g., occasional meal).

Qualified Transportation Fringes

- Code never states that this can be cash.
- Did not exist when Congress excluded fringe benefits from RRTA.
  - Exclusion codified in 1992 (Pub. L. 102-486)
  - Superfluous when excluded from RRTA, if "money remuneration" means cash.
- Reg. 1.132-9(b) allows reimbursements, but did not exist when Congress excluded fringe benefits from the RRTA.
  - Not adopted until 2001 (T.D. 8933, Jan. 11, 2001)
  - Superfluous when excluded from RRTA, if "money remuneration" means cash.
- Substantively, not cash, but an in-kind benefit (i.e., transportation).

Moving Expense Reimbursements & Qualified Military Base Realignment and Closure Fees

- Moving Expense Reimbursements not added to Section 132 until 1993 (Pub. L. 103-66)
- Military Base Realignment & Closure Fees not added to Section 132 until 2003
- Therefore superfluous when excluded from RRTA, if "money remuneration" means cash.

Employee Achievement Awards

- Cannot be provided in cash
- Taxpayer cites authority which:
  - Is not controlling.
  - Was not promulgated under section 74(c).
  - Does not state that gift certificates are "cash," but states that certain "nonnegotiable certificates" are "cash equivalents."

Meals and Lodging

- Can only be provided in kind.
- Statute does not include cash.
- Regulations explicitly exclude cash.
- Regulation cited by Taxpayer does not include cash.
- If "money remuneration" only includes cash, 3231(e)(9) is thus superfluous.

ISOs, ESOPs, & Stock Appreciation Rights

- ISOs and stock appreciation rights that are cashed out are subject to employment taxes.
  - Bagley v. Commissioner, 85 T.C. 663 (T.C. 1985)
  - Rev. Rul. 73-146, 1973-1 C.B. 61
  - Rev. Rul. 67-366, 1967-2 C.B. 165

Housing Accommodations and Revenue Ruling 69-391

Does not stand for proposition that the value of a benefit is subject to RRTA if it is "denominated in cash and offset[s] actual cash."

Housing Accommodations and Revenue Ruling 69-391 (continued)

Ruling states:

> *The value of employer-provided housing accommodations (i.e., the value of a benefit) is compensation under the RRTA if "an employer and employee have agreed that housing accommodations of an appropriate fixed value are a part of the employee's total remuneration."*

Housing Accommodations and Revenue Ruling 69-391 (continued)

- No requirement that benefit be "denominated in cash."

- No requirement that the benefit “offset actual cash.”
- Consistent with expansive reading of “money remuneration.”

Rebutting Specific Arguments: Part 2

- Taxpayer argues that if Congress intended for “money” to encompass stock, it would have stated so, as it did in section 731
- But, as Taxpayer notes, the reason that Congress added this language was to address a particular pattern of abuse by Taxpayers (Protest at 32 fn. 62).
- No such pattern of abuse is present here.

Conclusion

- RRTA and FICA are parallels.
- “Money remuneration” does not have a plain and unambiguous meaning.
- The best reading of “money remuneration” includes stock/equity payments.

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